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C O N F I D E N T I A L SECTION 01 OF 02 KYIV 001943

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STATE FOR EUR/UMB AND EEB/OMA

E.O. 12958: DECL: 11/08/2029
TAGS: EFIN EREL ECON PREL UP
SUBJECT: UKRAINE MINFIN ECONOMIST WANTS REFORM

REF: KYIV 1920

Classified By: Economic Counselor Edward Kaska for Reasons 1.4 (b) and (d)

¶1. (C) Summary. The new social spending law, which increases wages and pensions, would be disastrous for Ukraine's economic recovery, according to Volodymyr Parnyyuk, a leading Ministry of Finance economist. Even without the social spending increases, the GOU is facing a $3.75 billion or larger deficit that would require it to halt expenditures to all but "protected" items in the budget. Nonetheless, Parnyuk agreed with recent National Bank of Ukraine (NBU) resistance to monetizing the deficit. He also argued that it would be best if the bloated 2010 budget stalled in the parliament until after the presidential elections in January. End Summary.

## Social Spending Law Disastrous For Economic Recovery

¶2. (C) The recently signed social spending law (reftel) would result in wage and pension increases for a broad percentage of the population, according to Ministry of Finance Director for Macroeconomic Forecasting Department, Volodymyr Parnyuk. During a meeting with Econoff on November 5, Parnyuk noted that the wage increases would be disastrous for Ukraine's economic recovery, not to mention that the government had no money to implement the increases. Parnyuk repeatedly emphasized that the law had systemic economic consequences beyond its simple budgetary impact.

¶3. (C) Although President Yushchenko had argued that only minimum-level pensions and assistance payments would be increased by the social spending law, Parnyuk argued that all social payments would need to be adjusted upward. Without changes to other laws and regulations that link such payments to formulas based on the statutory subsistence minimum, the government would legally be required to implement a broad indexing of wage and pension hikes. Parnyuk said he understood the President's desire to guarantee a minimum standard of living for the people of Ukraine, but argued that wages had already increased significantly over the past few years.

## Wages Growing Since 2003

¶4. (U) Ukraine has made progress since 2003 to reduce the number of Ukrainians earning less than minimum wage and to bring Ukraine's minimum wage up to its minimum subsistence level. In 2003, 18.5% of employees earned less than the UAH 180 monthly minimum wage; 61.4% earned less than the subsistence level of UAH 342. By September 2008, only 4.8% of wage earners received less than minimum wage, which had increased to UAH 522 per month; and 13% were receiving less

than UAH 607, the subsistence level. These changes conform to a 2005 law that required elimination of the gap between the minimum wage and the subsistence level. The new social spending law, passed in October, provides for an initial rise in the monthly minimum wage to UAH 744 on November 1, with subsequent quarterly augmentations in 2010. The increases would continue until the minimum wage reached UAH 922 (roughly $112).

¶5. (C) Parnyuk argued that continuation of the policy of increasing minimum wages made little sense given the onset of the global economic crisis and Ukraine's GDP contraction of roughly 15% in 2009. The share of wages and pensions had already grown from 27.3% of GDP in 2004 to 30.1% in 2008. Parnyuk noted that wages as percentage of GDP were on track to jump significantly in 2009, even without increases required by the social spending law.

## Harmful Effects of the Social Spending Law

¶6. (C) Businesses would need to increase wages to keep workers at the expense of investment that might bring economic growth, Parnyuk said. Parnyuk thought that in 2009 the social spending bill would require UAH 8 billion (nearly $1 billion) to implement, much more than estimates from the Presidential Secretariat, which put the increase at roughly UAH 1 billion. Parnyuk argued that increased expenditures on wages and pensions would cause the shadow economy to grow, unemployment to increase, and stimulate those without work to continue to seek work abroad. He also argued that Ukraine would need to borrow more to finance the government deficit,



leading to inflation.

## GOU To Fund "Protected" Budgetary Items Only

¶7. (C) Parnyuk confirmed that the GOU needed at least $3.75 billion (UAH 30 billion) to cover budgetary obligations for the rest of the year, without the increased wages and pensions required by the social spending law. He speculated that the government would be reduced to funding only "protected" items in the budget (like wages to teachers, doctors, and law enforcement) but would not fund other items. Although Parnyuk thought the Prime Minister would try to avoid pension arrears, he said that some missed payments might be unavoidable. Parnyuk noted that arrears for goods and services were already accruing to the government.

## National Bank Should Hold The Line

¶8. (C) The National Bank of Ukraine (NBU) should continue to stand firm against monetizing the budget deficit, Parnyuk stated, as NBU emissions would lead to "growth-destroying" inflation. Parnyuk also worried that monetization would send the wrong signals to the country's leadership. In his view, the government should be forced to reform, something that would not happen if the NBU or the IMF bailed the GOU out time and again. Parnyuk commented that IMF funding for budgetary support scares off international investors. He noted that this tendency stood in contrast to the policy advocated by former Minister of Finance Viktor Pynzenyk, who had welcomed the discipline of an IMF program because he was convinced it would bring reform to Ukraine and send positive signals to international investors.

## 2010 Budget

¶9. (C) Parnyuk commented that it might be best for the 2010 budget, which PM Tymoshenko had submitted for parliamentary consideration, to stall in the Rada (Ukraine's parliament). Pressures were too great to inflate spending in advance of

the presidential election. If no budget were passed, the government would continue to operate at 2009 levels, and continue to make social payments at 2009 levels. Technically, the Rada Budget Committee had until October 20 to forward the budget for its first reading by the full Rada membership. Only after the first reading should the bill be sent back to the CabMin for approval or changes. The second reading of the budget should be completed by November 20; and the third and final reading by December 1, according to normal procedures.

Comment
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¶10. (C) While Parnyuk's views may differ from those publically espoused by his superiors at the Ministry of Finance, they reflect the thinking of a careful economist with the best interests of the economy in mind. Parnyuk's concern that the government had not yet been forced to reform and was delaying the pain of real economic adjustment by borrowing or monetizing is well placed. At this point, real economic reform has no chance in Ukraine before the January election. Similarly, with the IMF program already off track, it appears likely the GOU will continue to stall on cutting 2010 budget expenditures. However, as the treasury is depleted and gas payments mount, future Ukrainian authorities will have few options in early 2010 other than to implement some of the needed reforms and entice the IMF back to Ukraine. End Comment.

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